

DOCUMENT RESUME

03243 - [A2353467]

The Adequacy of Settlements of Cost Accounting Standards Noncompliance Cases. PSAD-77-158; B-39995. August 17, 1977. 6 pp.

Report to Secretary, Department of Defense; by Richard W. Gutmann, Director, Procurement and Systems Acquisition Div.

Issue Area: Federal Procurement of Goods and Services (1900).  
Contact: Procurement and Systems Acquisition Div.

Budget Function: National Defense; Department of Defense - Procurement & Contracts (058).

Organization Concerned: Defense Contract Audit Agency.

Congressional Relevance: House Committee on Armed Services;  
Senate Committee on Armed Services.

Authority: P.L. 91-379.

A limited survey of the settlement of cost accounting standards (CAS) noncompliance cases by Department of Defense (DOD) contract administration personnel was conducted to determine whether timely and appropriate action was taken to settle noncompliance cases and whether contractor cost impact proposals were obtained, evaluated, and negotiated in accordance with applicable defense procurement regulations.

Findings/Conclusions: In 25 of 37 noncompliance cases reported by the Defense Contract Audit Agency (DCAA) to contracting officers, timely action was taken to settle the issues, but for the remaining 12 cases, it was believed that the officers could have taken more action to obtain a timely settlement. Appropriate actions were taken by contractors to comply with CAS on all settled cases through changes in cost estimating, accounting practice, or disclosure statements. Cost impact estimates were submitted by contractors or prepared by DCAA for 12 of the 32 settled cases reviewed. The small number of cost impact proposals was believed to be due to the lack of significance of most of the CAS noncompliance cases. At two contract administration offices, the largest number of reports of noncompliance involved failure to estimate and account for costs in a consistent manner. Changes in estimating practices were promised by contractors in 16 cases. At two offices, nine noncompliance reports involved issues identified during reviews of subcontract price proposals. Agency guidance may be too restrictive in requiring referrals to the administrative contracting officer cognizant of the prime contractor.

Recommendations: Prompt settlement of noncompliance issues should be emphasized. The reporting of noncompliance should be reviewed with the objective of eliminating unnecessary duplication. Administrative contracting officers who are cognizant of subcontractors' plants should be permitted to settle noncompliance cases not involving monetary considerations. (Author/HTW)



**UNITED STATES GENERAL ACCOUNTING OFFICE**

**WASHINGTON, D.C. 20548**

3467

03243

**PROCUREMENT AND SYSTEMS  
ACQUISITION DIVISION**

**B-39995**

**AUG 17 1977**

**The Honorable  
The Secretary of Defense**

**Lear Mr. Secretary:**

We have completed a limited survey of the settlement of cost accounting standards (CAS) noncompliance cases by Department of Defense (DOD) contract administration personnel. The objective of the survey was to determine whether timely and appropriate action was taken to settle noncompliance cases, and whether contractor cost impact proposals were obtained, evaluated, and negotiated in accordance with applicable defense procurement regulations. This survey represents part of our program to monitor Federal agencies' efforts to assure compliance with CAS requirements.

Public Law 91-379, approved August 15, 1970, established the Cost Accounting Standards Board to promulgate standards designed to achieve uniformity and consistency in the application of cost accounting principles by defense prime contractors and subcontractors. DOD amended the Armed Services Procurement Regulation (ASPR) to provide for the implementation of the Board's requirements at the contracting level.

The administrative contracting officer has been assigned the responsibility for administering cost accounting standards. Although the final decision regarding contractor compliance rests with the contracting officer, basic responsibility for evaluating contractor compliance was delegated to the contract auditor. When the auditor believes that a contractor is in noncompliance with the standards or disclosed accounting practices, a report is prepared and issued to the administrative contracting officer responsible for that contractor. The contracting officer, after reviewing the report and any other pertinent information, makes a final determination. If a determination is made that the contractor is in noncompliance and that such noncompliance results in increased costs to the Government, the contracting officer will request the contractor to submit a cost impact proposal. If the contractor fails to submit the proposal, the contracting officer, with the assistance of the auditor, will estimate the cost impact of the noncompliance.

Our survey which covered noncompliance cases reported during fiscal years 1975 and 1976 was performed at five

**PSAD-77-158  
(950300)**

contract administration field offices--two Air Force Plant Representative Offices and three Defense Contract Administration Services Management Area Offices. We found that, on balance, contract administration officials were processing CAS noncompliance cases in accordance with defense procurement procedures. Although CAS noncompliance cases were generally processed in a timely manner, a number of significant delays did occur. Appropriate corrective actions were taken for all closed cases. Only a small number of cost impact proposals were submitted and negotiated because most of the settled cases involved minor noncompliances which did not materially affect contract prices or cost reimbursements.

We identified opportunities for DCA to reduce administrative effort in processing minor noncompliance cases and to handle subcontractor noncompliances more expeditiously. Recommendations for improvements are on page 5.

#### SETTLEMENT OF NONCOMPLIANCE CASES

Our survey covered 56 CAS noncompliance cases reported by the Defense Contract Audit Agency (DCAA) to administrative contracting officers. In 37 cases, the administrative contracting officers agreed with the auditors' findings. In seven cases, however, the contracting officers disagreed with the auditors and concluded that the contractors were in compliance. For the remaining 12 cases, the contracting officers did not make formal determinations because the matters were (1) considered insignificant, (2) resolved without the need for a determination, or (3) referred to the cognizant administrative contracting officers at the prime contractors for resolution.

Corrective action was taken to resolve 32 of the 37 noncompliance issues. On the other five cases, action was either pending or the noncompliance determinations had been withdrawn.

#### Timeliness

In 25 of 37 noncompliance cases, timely action was taken to settle the issues. For the remaining 12 cases, we believe the contracting officers could have taken more vigorous action to obtain a timely settlement.

An example of timely action involved a noncompliance with CAS 401--consistency in estimating, accumulating, and reporting costs. In this case, labor costs were proposed in greater detail than were recorded in the accounting records. Within 2 months of the date of the noncompliance report,

appropriate action was taken by the contractor to revise its accounting system. Government review and approval of the change was also accomplished during the period.

An example of untimely processing involved a contractor's failure to estimate, accumulate, and report labor and material variances at the appropriate level of detail, as required by CAS-407--use of standard costs for direct material and direct labor. During the 10-month period following the noncompliance determination, numerous correspondence was exchanged among the contractor, administrative contracting officer, and DCAA in an attempt to resolve the case and reach agreement on cost impact. In a subsequent 8-month period, we found no action by the contracting officer. At the completion of our survey, 21 months had elapsed and the case was still open.

We believe there is a need to emphasize the importance of prompt action by contracting officers in settling noncompliance cases. Protracted settlements usually involve excessive investments of time by contractor and agency officials and adversely affect the relationship between the contracting parties.

#### Corrective action

Appropriate actions were taken by contractors to comply with CAS on all 32 settled cases through changes in established cost estimating, accounting practice, or disclosure statements.

A number of noncompliance cases involved inconsistent estimating practices that were identified during audits of contractors' price proposals. The estimated cost impact of each noncompliance on the proposed contract price was reported to the contracting officers. We noted that the contracting officers were able, in a number of cases, to negotiate appropriate reductions in the proposed prices. Also, contractors changed their estimating practices to comply with CAS.

#### COST IMPACT PROPOSALS

Cost impact estimates were submitted by the contractors, or prepared by DCAA, for 12 of the 32 settled cases reviewed. Cost impact proposals were not submitted for the remaining 20 cases because (1) corrective action involved a one-time change in estimating practices, (2) the proposals had been requested but not submitted at the time of our survey, or (3) it was obvious from the substance of the noncompliances that contract costs were not materially affected.

Eight proposals were settled after evaluation by the administrative contracting officers, with the assistance of DCAA. The remaining four were in the process of being evaluated or negotiated at the time of our survey. Three of the eight settled cost impact proposals resulted in reductions of about \$270,000 in allocable overhead expenses. The remaining five were considered immaterial in amount.

For each of the settlements, we reviewed the Government analyses of cost impact proposals to verify that sound techniques had been used in determining the reasonableness of the proposals. We also considered the significance of the non-compliance cases and the potential impacts on contract prices and cost reimbursements. In every case, we found that appropriate actions were taken by contracting officers in requesting, evaluating and negotiating cost impact proposals.

We believe that the small number of cost impact proposals and low dollar-value settlements were primarily due to the lack of significance of most of the CAS noncompliance cases.

#### OPPORTUNITY TO REDUCE ADMINISTRATIVE EFFORT

At two contract administration offices, the largest number of DCAA reports of noncompliance involved CAS 401, failure to estimate and account for costs in a consistent manner. The corrective action promised by the contractors in 16 cases involved changes in estimating practices. The promised action in some cases was obtained by DCAA during proposal audits prior to issuance of the noncompliance reports. Administrative and procurement contracting officials were notified of CAS non-compliances and the potential impact on contract pricing by DCAA in evaluation reports of contractors' price proposals. Our review of subsequent price proposal evaluations disclosed that, for the most part, the same noncompliance issues did not recur.

Where a noncompliance was found during the proposal review, DCAA usually included the noncompliance in the evaluation report as well as a special CAS noncompliance report. This procedure is in accordance with its own guidance to inform the procurement contracting officer and the administrative contracting officer responsible for administering CAS. Since the administrative contracting officer generally received both reports, the dual reporting appears to be unnecessary.

Where the contractor agrees to correct the noncompliance by changing its estimating practices, and the matter is included in the auditors proposed evaluation report, it may be appropriate to dispense with the normal CAS noncompliance process involving (1) DCAA separate reports of noncompliance, (2) contracting officer determinations, and (3) contractor replies to the determinations. In the event the noncompliance is found in a subsequent price proposal, a noncompliance report can then be issued and the normal administrative procedures followed.

### PROCESSING SUBCONTRACTOR NONCOMPLIANCE CASES

At two contract administration offices, nine CAS noncompliance reports involved issues identified during the auditors' reviews of subcontract price proposals. In three of the cases, the administrative contracting officers cognizant of the subcontractors' plants followed agency guidance and referred their recommendations on the noncompliance issues to the contracting officers cognizant of the prime contractors. In the other six cases, the issues were satisfactorily resolved by the contracting officers dealing directly with the subcontractors without referrals to the higher echelon. We agree with the appropriateness of the actions taken in the latter cases. None of the cases involved cost impact.

Agency guidance may be too restrictive in requiring referrals to the administrative contracting officer cognizant of the prime contractor. It appears feasible and desirable for the contracting officer cognizant of the subcontractor to resolve noncompliance cases which have no cost impact. Resolution of cost impact proposals would remain the responsibility of the prime contractor's contracting officer.

### RECOMMENDATIONS

We recommend that you:

- Emphasize to contracting officers the importance of promptly settling noncompliance issues.
- Review the reporting of contractors' noncompliances with the objective of eliminating all unnecessary duplication.
- Permit administrative contracting officers cognizant of subcontractors' plants to settle noncompliance cases not involving monetary considerations.

- - - -

As you know, section 236 of the Legislative Reorganization Act of 1970 requires the head of a Federal agency to submit a written statement on actions taken on our recommendations to the House Committee on Government Operations and the Senate Committee on Governmental Affairs not later than 60 days after the date of the report and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report. We would appreciate receiving a copy of these statements.

We are sending copies of this letter to the Commander, Air Force Contract Management Division; the Directors, Defense Logistics Agency, Defense Contract Audit Agency, and Office of Management and Budget; the Chairmen, House Committee on Government Operations, Senate Committee on Governmental Affairs, the House and Senate Committees on Appropriations and Armed Services, and other interested parties.

Sincerely yours,



R. W. Gutmann  
Director